Fitch Ratings

FITCH RATES $500MM MARYLAND GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-07 July 2015: Fitch Ratings has assigned an 'AAA' rating to $500 million in State of Maryland general obligation (GO) bonds, state and local facilities loan of 2015, second series, consisting of:

--$450 million second series A, tax-exempt bonds (competitive);
--$50 million second series B, taxable bonds (competitive).

The bonds are expected to sell via competitive sale as early as July 16, 2015.

In addition, Fitch affirms the ratings on related obligations of the state, as described at the end of this release:

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations to which the state's full faith and credit are pledged.

KEY RATING DRIVERS

CONSERVATIVE FINANCIAL OPERATIONS: Financial operations are conservatively managed, and the state maintains a well-funded rainy day fund. The state took repeated action during the course of the last recession to address projected budget gaps, including raising tax revenues, cutting spending, and using rainy day and other balances.

STRONG DEBT MANAGEMENT: Debt oversight is strong and centralized, and the debt burden is moderate. The state has policies to maintain debt affordability, and the constitution requires GO and transportation bonds to amortize within 15 years.

PENSION FUNDING REFORMS: Pension funding levels have deteriorated, although the state has undertaken extensive reforms to pensions and other post-employment benefits to improve funding levels.

BROAD ECONOMY: The state has a diverse, wealthy economy, benefiting from its proximity to the nation's capital.

RATING SENSITIVITIES

CONTINUATION OF CURRENT PRACTICES: Sound fiscal management practices and the consistent maintenance of fiscal flexibility (including budgetary reserves) are expected to provide the state with significant ability to respond to near-term economic or fiscal conditions, such as federal budget reductions, in a manner consistent with the 'AAA' rating.

CREDIT PROFILE

The 'AAA' rating on Maryland's GO bonds reflects its sound financial operations, a wealthy, diversified economy and strong management of debt. The state's economy has long benefited from proximity to the nation's capital, although recent federal budget sequestration poses greater uncertainty for Maryland given its large federal agency presence and associated private contracting. Despite this risk and the generally slow growth of the current economic expansion, the state's diverse and wealthy service-oriented economy remains a source of credit strength.

Maryland's approach to fiscal management has been consistently conservative both through the last recession and during the recovery, with the state relying on spending cuts, revenue increases and the use of non-recurring resources to maintain balance. Maryland retains ample fiscal flexibility, including a well-funded rainy day fund. Although pension funded ratios are weak, the state has implemented several rounds of reform to benefits and contribution practices intended to strengthen funded ratios over time.

WEALTHY, DIVERSE ECONOMY

Maryland's economy is wealthy and diverse, and has continued to expand in recent years despite the drag posed by federal austerity, which remains an ongoing risk to state economic performance. After unusually slow gains in early 2014, employment gains over the last year have improved; May 2015 employment rose 1.7% year-over-year, compared to 2.2% nationally.

Job gains in May were particularly strong in Maryland's services sectors, including in education and health, professional and business services, and leisure and hospitality. The construction sector has also contributed to recent growth. Gains in total government employment have been weak through the current expansion, with federal sequestration combining with limited growth or declines in state and local jobs.

The state's unemployment rate, at 5.3% in May 2015, was just below the 5.5% national average for the same period. Measured on a per capita basis, Maryland's 2014 personal income ranks fifth among the states, at 119.5% of the U.S. level. Personal income has grown steadily in recent quarters, albeit just below national levels; in the first quarter, it rose 4% in Maryland, compared to 4.4% nationally.

The state's March 2015 economic outlook appears conservative, with steady estimated gains in 2015 continuing through the 2018 forecast period. In 2015, employment is forecast to rise 1.1% and personal income 3.8%, after weaker performance in 2014. Growth is forecast to accelerate slightly in 2016, with employment rising 1.3% and personal income up 4.1%.

CONSERVATIVE FINANCIAL OPERATIONS

Financial operations are conservatively maintained, with the state demonstrating a strong commitment to budgetary balance through the downturn and the slow recovery that has followed. The state has maintained flexibility in the form of its rainy day fund (RDF), which remained funded at or near 5% of general fund revenues through the downturn, as well as its practice of responding quickly to changing budgetary circumstances through repeated spending cuts, fund balance transfers and revenue increases.

Recent state fiscal management has been consistent with past practices. Fiscal 2015 opened with lingering uncertainty from the weak general fund revenue performance of late 2014 (tied to the impact of 2012 federal tax law changes on state individual income tax filings). The state responded quickly, with the board of public works (consisting of the governor, treasurer and comptroller) cutting fiscal 2015 general fund appropriations in July 2014 ($76 million) and January 2015 ($198 million), and the bureau of revenue estimates in September 2014 lowering the fiscal 2015 general fund revenue forecast $123.2 million, primarily in individual and corporate income taxes.

Fiscal 2015 performance improved in the latter half of the fiscal year. Year-to-date general fund revenues through May are 2% above estimated levels and 6.4% ahead of fiscal 2014, driven primarily by the impact of steady economic gains on individual income collections. Fiscal 2015 general fund revenues are forecast to end 4% higher than the previous year as of fiscal 2016 budget adoption. Fiscal 2015 appropriations and other uses are forecast to end 2.7% above fiscal 2014 levels; this includes the funding of $188 million in deficiencies for Medicaid, K-12 education and other needs, as well as cuts noted earlier by the Board of Public Works (BPW) and by the legislature in the 2015 session. As of June 30, 2015, the general fund ending balance is estimated at $52.7 million (0.3% of general fund revenues), and the RDF balance is estimated at $766.1 million (4.9%).

The adopted budget for fiscal 2016 assumes general fund revenue growth of 3.9%, based on the March 2015 forecast and a handful of other actions by the legislature affecting revenues. Income and sales taxes are forecast to rise 5.9% and 4.8%, respectively. Appropriations are forecast to rise 2.8%. The budget incorporated across the board reductions to forecast spending increases and merit pay, and absorbs higher Medicaid enrollments through cuts to provider reimbursements. It also includes $202 million in restricted spending that the governor may opt not to fund, and accelerates recent reforms affecting pension contributions, as noted below. The budget forecasts fiscal 2016 ending with a narrow general fund balance of $27.6 million (0.2% of revenues) and an RDF balance at $794.1 million (4.9% of revenues).

STRONG DEBT MANAGEMENT

The burden of Maryland's total tax-supported debt is moderate, and its strong and centralized debt management remains a credit strength. Fitch calculates net tax-supported debt as of March 31, 2015 of approximately $12.2 billion, or 3.7% of 2014 personal income; these figures include the current sale. About three-fourths of tax-supported debt is GO bonds. GO and transportation bonds are constitutionally required to mature within 15 years, ensuring rapid amortization. Debt affordability guidelines include holding tax-supported debt at or below 4% of personal income.

On a combined basis, net tax-supported debt and pension liabilities attributable to the state as of Fitch's May 2014 state pension update report were estimated at about 10.7% of personal income, above the states' median of 6.1%.

PENSION FUNDING LOW BUT IMPROVING

The funding for the state's largest pension obligations - covering state employees and teachers - has begun to improve after a decade of weakening that resulted from an actuarial contribution methodology now being phased out and market losses in the last downturn. On an actuarial basis, funded ratios as of June 30, 2014 rose to 61.9% for state employees and 70.7% for teachers; the corresponding funding was 59.7% and 65.4% as of June 30, 2010.

Under new GASB pension accounting requirements the state is reporting higher ratios of assets to liabilities. As of June 30, 2014, assets to liabilities measured 69.5% for the employees' system (including certain local employees) and 73.7% for teachers. Using Fitch's more conservative 7% discount rate assumption (compared to the 7.65% used by the system in 2014), the employees and teachers plans would be funded at 64.9% and 62.3%, respectively.

Pensions are a comparative credit weakness in Maryland, although the state has taken repeated action since 2011 to reform benefits and contributions to strengthen funding. Reforms have included lower benefit accruals, higher service requirements, a phased-in decline in the discount rate, ending (as of fiscal 2017) a contribution methodology that had consistently left actual contributions below actuarial calculations and replacing it with full actuarial contributions, and appropriating supplemental contributions. Given the changes implemented to date, Fitch views the prospects for funding improvement to be increased assuming investment performance matches expectations. Additionally, changes in 2011 to other post-employment benefits are estimated to have reduced the state's OPEB liability to $9.2 billion, from $15.9 billion as of June 30, 2011; the total unfunded OPEB liability as of June 30, 2014 is $8.7 billion.

RELATED RATINGS

Fitch affirms the long-term ratings on the following outstanding bonds of the State of Maryland:

--$8.7 billion in outstanding state GO bonds at 'AAA';
--$18.6 million in Maryland Transportation Authority parking lease revenue bonds series 2005 at 'AA+';
--$8.6 million in Maryland certificates of participation, series 2011A at 'AA+';
--$153.3 million in Maryland Stadium Authority bonds at 'AA'.

The Rating Outlook on all of the bonds is Stable.

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Applicable Criteria
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033